



Philanthropic NEWS

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UPDATE ON SOCIAL ENTERPRISE STRUCTURES

Over the past few months, there have been significant developments regarding alternative legal structures for enterprises that combine a social purpose and a business purpose. The alternative structures are needed because neither traditional charities nor for-profit business structures allow entrepreneurs enough freedom to pursue each goal in ways best suited to success.

In November 2006, a group of approximately 20 experts in law, finance and business met under the auspices of the Aspen Institute to discuss various ideas and proposals for new approaches to social enterprise, including hybrid legal forms. Topics ranged from allowing charities to issue shares to tax credits and a new category of tax exemption for businesses that engage in socially beneficial practices. Specific legal forms were discussed, including "charitable LLCs," "for-benefit corporations," "B corporations," and "socially responsible corporations." While no consensus on a single approach was reached, several working groups were formed to develop these ideas further.

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PANEL ON THE NONPROFIT SECTOR SEEKS PUBLIC COMMENT ON PRINCIPLES FOR SELF-REGULATION

The Panel on the Nonprofit Sector, formed by Independent Sector in October 2004 at the encouragement of the U.S. Senate Finance Committee, invites public comment on its Draft Principles for Self-Regulation, which seek to guide charities in conducting their activities by the highest ethical standards. The Draft Principles were prepared by a special Advisory Committee on Self-Regulation of the Charitable Sector, established by the Nonprofit Panel, which includes 34 leaders from charities, foundations, and academic institutions.

Underlying these Draft Principles is the view that while well-crafted, well-enforced laws and regulations are crucial to protecting charitable organizations from individuals who intentionally use them for personal gain, a strong system of self-regulation and education is also critical in enabling all participants in the nonprofit community (e.g., boards, staff, volunteers, and donors) to ensure that their organization operates with the highest integrity.

The Draft Principles are divided into the following four categories:

1. **Facilitating Legal Compliance:** This category highlights certain responsibilities and practices, such as the use of conflict of interest and whistleblower policies that will assist charities in complying with their legal obligations.

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SOCIAL ENTERPRISE STRUCTURES

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Alan Kay, a noted futurist and visionary, has proposed a new business feature that could be called “self-dissolving ownership” for private companies. The idea is that investors would agree to a cap on their total returns, and as they received income from the company, their percentage of ownership would decrease (by the amounts received) until it dwindles to zero when the cap is reached. There would always be some shareholders so long as the company issues new rounds of equity, but if it did not, all ownership interests would eventually disappear, and the company would essentially become a nonprofit corporation, which has no shareholders. Ownership interests would be transferable, but only at a price set each year by the company itself, which would be obligated to purchase the shares if no other buyer could be found.

Finally, Tom McLaughlin at the accounting firm of Grant Thornton, LLP has suggested a new form of financing he calls “cap and lock.” Under McLaughlin’s proposal, start-up ventures could enter into agreements with investors in which the investors would accept a cap on dividend payments, and the investment would be non-transferable. This would give new ventures a source of long-term capital, while allowing investors to realize both a social and financial return on investment.

These are just a few examples of the thinking going on in this emerging area, and this firm is following them closely. We also expect to release our own white paper describing a variety of forms and arrangements that allow social enterprises to operate under existing law, as well as a proposal for a new form of entity that is different from those that have been proposed so far. If you would like to know more about these efforts, or if you need help developing a structure for your own social enterprise, please contact Allen Bromberger at allen@perlmanandperlman.com.

NEW POSTAL REFORM LAW AFFECTS CHARITIES

On December 20, 2006, President Bush signed into law H.R. 6407, the “Postal Accountability and Enhancement Act,” which significantly affects U.S. Postal Service rate changes. Although the legislation applies to all individuals and entities that use the U.S. Postal Service, nonprofits will benefit directly from the comprehensive reform measures.

Most notably, under the new law, rate increases are linked to the Consumer Price Index (CPI) and a 10-year cap is placed on stamp prices rising faster than the rate of inflation. As a result, nonprofit and direct mail organizations will be able to rely on more affordable and predictable postage rate increases and thereby have more certainty in planning for mailings and spending.

The following are key provisions of the new law:

- The law divides postal products into “market-dominant” and “competitive” categories. “Market-dominant products” include first-class mail letters and sealed parcels; periodicals; standard mail; single-piece parcel post; media mail; and bound printed matter. “Competitive products” include priority mail; expedited mail; and bulk parcel post.
- For the next 10 years, increases in market-dominant product rates cannot be greater than the inflation rate. The new law links postal rate increases of market-dominant products to the change in the Consumer Price Index such that the rise in stamp prices cannot increase faster than inflation rates. This provision will be up for review and revision 10 years after the law’s enactment.
- Competitive product rate increases are not capped. Any changes to the rate and class of competitive products will be set by the Board of Governors, under rules that ensure each competitive product covers attributable costs and a share of the Postal Service’s institutional costs.
- New rates will be set more quickly. The new law allows postage rate changes of market-dominant products to be implemented 45 days after public notice. Under the current process, this change can take up to a year.
- The USPS will have more flexibility to create new postal products. The law includes provisions allowing for market tests of experimental or new products.
- In the 18 months following enactment of the law, the Postal Regulatory Commission (PRC) must develop regulations for market-dominant products. In establishing new regulations, the PRC is required to achieve 9 objectives which include creating predictability and stability in rates and allowing the USPS flexibility in pricing. The PRC must also take into account 14 factors in establishing the system, such as the effect of rate increases upon the general public, business mail users, nonprofit organizations, and private sector enterprises engaged in the delivery of mail.

SELF-REGULATION PRINCIPLES

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2. **Effective Governance:** This category covers policies and procedures that boards of directors should implement to effectively fulfill oversight and governance responsibilities.
3. **Strong Financial Oversight:** This category includes policies and procedures that charities should follow to ensure proper stewardship of the organization's charitable resources.
4. **Responsible Fundraising:** This category covers policies and procedures that charities soliciting contributions from the public should follow to strengthen donor support and confidence. It should be noted that the Advisory Committee has not yet reviewed and approved the seven principles in this category.

The Advisory Committee recommends that all charities aspire to follow these principles and all major organizations (public charities with at least \$1 million in annual revenues and private foundations with at least \$25 million in assets) should implement these practices.

Comments submitted by January 24, 2007 will be incorporated by the Advisory Committee into the recommendations it submits for the Panel's consideration. Comments received thereafter and until February 2nd will be reviewed by staff and relevant ideas will be referred to the Nonprofit Panel. Final Principles will be released in a final report in late Spring 2007.

The Draft Principles are available at <http://www.nonprofitpanel.org/selfreg/>.

IRS RELEASES INTERIM GUIDANCE ON PENSION PROTECTION ACT

On December 4, 2006, the IRS released Notice 2006-109, "Interim Guidance Regarding Supporting Organizations and Donor Advised Funds" to provide guidance on the requirements enacted as part of the Pension Protection Act of 2006 ("PPA").

Distributions to Supporting Organizations

The Notice provides guidance on the criteria to be used by private foundations in making distributions to supporting organizations. The Notice states that until further guidance is issued, private foundations may rely on information from the IRS Business Master File ("BMF") or the grantee's current IRS determination letter

indicating the grantee's public charity classification in determining whether the grantee is a public charity under Section 509(a)(1), (2), or (3).

A grantor may also rely on a written representation from a grantee signed by an officer, director or trustee of the grantee and documents specified in the Notice in determining whether the grantee is a Type I, Type II or functionally integrated Type III supporting organization. In the alternative, a foundation may rely on a written opinion of counsel of either the grantor or the grantee concluding that the grantee is a Type I, Type II or functionally integrated Type III supporting organization.

The Notice also states that a private foundation considering a grant may need to obtain a list of the grantee's supported organizations to determine whether an organization is controlled by disqualified persons of the private foundation. Similarly, a sponsoring organization considering a grant from a donor advised fund to a Type I, Type II or functionally integrated Type III supporting organization may need to obtain a list of the grantee's supported organizations to determine whether any of the supported organizations is controlled by the fund's donor or donor advisor.

Applicability Date for Excess Benefit Transactions by Supporting Organizations

Under section 4958(c), as amended by the PPA, any grant, loan, compensation, or other similar payment by a supporting organization to a substantial contributor to the supporting organization or a person related to a substantial contributor, and any loan provided by a supporting organization to certain disqualified persons is treated automatically as an excess benefit transaction. Recognizing that a supporting organization may have entered into a contract or legal obligation to pay substantial contributors, or persons related to substantial contributors for goods or services, or to provide a loan to a disqualified person prior to the enactment of the PPA, the Notice provides that the IRS will not consider any payment made pursuant to a written contract that was binding on August 17, 2006 as an excess benefit transaction, provided that the contract was binding at all times after August 17, 2006 and that before payment is made, the contract is not modified and the payment under the contract is made on or before August 17, 2007.

Similarly, with respect to an arrangement that is not governed by a binding contract, the IRS will not consider any payment an excess benefit transaction if: (a) the terms of such arrangement are not modified after August 17, 2006, (b) any services are performed and any goods are delivered no later than December 31, 2006, and (c) payment is made no later than August 17, 2007.

UPCOMING SPEAKING ENGAGEMENTS AND ANNOUNCEMENTS

Perlman & Perlman is proud to announce that Allen R. Bromberger has become a partner of the firm. In addition, Mr. Bromberger was named chair of the Alliance for Nonprofit Management as of January 1, 2007 to serve a two-year term. The Alliance is a professional association of individuals and organizations devoted to improving the management and governance capacity of nonprofits - to assist nonprofits in fulfilling their mission.

Perlman & Perlman is proud to announce that Angelia M. Dickens has joined the firm as "Of Counsel." Ms. Dickens has extensive experience advising on corporate matters for for-profit and nonprofit clients. Prior to joining Perlman and Perlman, Ms. Dickens served as General Counsel of Safe Horizon, a nonprofit organization that works with victims of crime and abuse. Ms. Dickens holds a B.S.F.S. in International Relations from Georgetown University (1993) and a J.D. from Columbia Law School (1996). She is a member of the Board of Directors of the Columbia Law School Alumni Association and Groundwork, Inc., a youth development organization in Brooklyn, N.Y. Her e-mail address is angelia@perlmanandperlman.com.

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